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Determinants of Dividend Policy: Evidence from Polish Listed Companies

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Abstract

Dividend policy has been still a controversial issue in corporate finance. The question, when and why do firms pay dividends, is still valid. Vast literature has examined the dividend policies of firms from developed countries, especially from U.S. Relatively little research has yet been published examining the dividend policies of companies from emerging countries. The main goal of this paper is to examine cash dividend payments of Polish listed companies. In this study, panel data analysis is applied to investigate the determinants of dividend policies of Polish companies. The paper also explains the impact of different factors on dividend policy on Polish market. Moreover, it tries to examine whether the same factors (profitability, liquidity, size, leverage of the firm) affect dividend payout decisions on Polish market as on developed countries.

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1. Introduction

The notion that dividends policy is an important aspect of corporate finance and it has implications for many group of company's stakeholders (investors, managers, lenders) is not new. The discussion on its relevance has been ongoing since the pioneering works of Gordon (1959), Lintner (1956, 1962) and Miller and Modigliani (1958, 1961). Black (1976) wrote that "the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just do not fit together". Since the mentioned work of Black, dividend payout policy has been the primary puzzle in corporate finance. There are many questions which seem to be unsolved or the answers which are still

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controversial: why do firms pay dividends and why do shareholders pay attention to dividend? What are the factors which affect the dividend decision in a company? Whether the dividend policy affect the value of a firm?

This paper is organized as follow: section 2 describes the literature review. Section 3 discusses the hypothesis tested in the study. Section 4 discusses the results of the empirical research. Section 5 presents the conclusions that have been drawn from the results of the study.

2. Literature review

As mentioned before many theories have been propounded to explain dividend decisions and the relationship between dividend policy and the value of a firm. Modigliani and Miller (1958) started a discussion on capital structure and dividend policy presenting the irrelevance theory. The MM theory provides conditions under which a company's financial decisions do not affect its value. The authors argued that given the perfect market assumptions, value of the company is unrelated to its capital structure and dividend policy. Continuing studies Modigliani and Miller (1963) overruled one of perfect capital market's assumptions, analyzing the impact of capital structure on the value of the company, taking into account corporate tax. The authors concluded that in such circumstances, there is an optimal capital structure of the firm. The found that the value of the firm increases as the debt level increases.

Lintner (1962) and Gordon (1963) were the primary supporters of the theory that corporation's share price (or its cost of capital) is not independent of the dividend rate. They argued that the investors valued dividends more than capital gains and the more money a company pays as dividend the more valuable it becomes, therefore the dividend policy is relevant. This theory, known as "bird in hand theory", states that the money paid to shareholders is more valuable than the money reinvested.

On the other hand, Litzenberger and Ramaswamy (1979) argued that investors are disadvantaged in receiving cash dividends. The researchers claims that investors prefer lower payout companies for tax reasons. The implication of Litzenberger and Ramaswamy's tax preference theory is that firms could increase their share prices by reducing dividends.

A number of variables, potentially responsible for the determining company's dividend payout decisions have been discussed in the literature. In this study, the set of following explanatory variables has been chosen: leverage, liquidity, profitability, size, risk.

1.1. Leverage

A company's leverage has been analysed in the literature as an important factor for the dividend policy decisions. Rozeff (1982) argues that high leverage increase the transaction costs and the risk of the firm. Firms with high leverage ratio have high fixed payments for using external financing. Therefore the higher the leverage ratio, the lower the chance for dividend as a consequence leverage is negatively related to dividends. This result is supported by the agency cost theory of dividend policy.

1.2. Liquidity

Liquidity condition of a firm is affected but also affects dividend decisions. Firms with higher cash availability are more likely to pay dividends than firms with insufficient level of cash. Therefore, the likelihood a firm will pay cash dividends is positively related to liquidity. This positive relationship is supported by the signaling theory of dividend policy (Ho, 2003).

1.3. Profitability

Profitability has been found as one of the most important determinants of dividend policy. The pecking order theory, which explains how companies prioritize their financing sources, states that firms prefer to use internal funds. When internal funds are insufficient to meet financial needs, firms turns to debt (first to risk free, then risky debt), and finally equity (Myers 1984, Myers and Majluf 1984). Myers (1984) suggests that this behavior may be